

**Before the  
Federal Communications Commission  
Washington D.C.**

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In the Matter of	)	
	)	
Implementation of Section 6002(b) of the	)	
Omnibus Budget Reconciliation Act of 1993	)	WT Docket No. 06-17
	)	
Annual Report and Analysis of Competitive	)	
Market Conditions With Respect to Commercial	)	
Mobile Services	)	
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**REPLY COMMENTS OF VIRGIN MOBILE USA, LLC**

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## **SUMMARY**

As the first U.S. wireless service designed specifically for the needs and desires of younger and lower-income, lower-usage consumers, Virgin Mobile has experienced significant growth in its four years of operation. Virgin Mobile's simple and straightforward pricing, along with its high-quality customer service, has helped to redefine the prepaid wireless marketplace and contributed greatly to its growth. Virgin Mobile's rapid success, and the subsequent entry of additional Mobile Virtual Network Operators ("MVNOs"), demonstrates the vitality of the resale market and the competitive benefits provided by resold wireless services, especially prepaid providers. Indeed, resold wireless services can provide significant competition to traditional wireless services so long as the resold provider differentiates its services from those of the national carriers. By focusing on data, entertainment, and voice applications that appeal to its targeted customer base, Virgin Mobile has provided competition and attained a disproportionately high market share for these new services.

The most significant threat to the competitive benefits provided by Virgin Mobile and other new market entrants is the dual burden of increasing state and local taxation and regulation of wireless services. Accordingly, Virgin Mobile asks the Commission to investigate whether increasing state and local taxation and regulation have the potential to create significant barriers to entry in the wireless market. Finally, Virgin Mobile believes that meaningful Universal Service Fund ("USF") reform would protect innovative business models, especially prepaid wireless services. The imposition of a flat, monthly USF fee would be a regressive fee that would unfairly penalize lower-usage, less-affluent customers and, accordingly, discriminate against providers of prepaid wireless services, such as Virgin Mobile.

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Virgin Mobile USA, LLC ("Virgin Mobile"), by its undersigned counsel and pursuant to the Commission's Public Notice in the above-referenced proceeding, hereby submits its reply comments.<sup>1</sup>

**I. COMPANY BACKGROUND**

**A. Overview**

Virgin Mobile is a joint venture between Sir Richard Branson's Virgin Group and Sprint. Virgin Mobile commenced operations in July 2002 with its prepaid, pay as you go service targeted to a previously underserved consumer segment: low-income, low-usage subscribers - with a specific focus on the youth market. Sprint's nationwide CDMA network provides the wireless backbone and infrastructure for Virgin Mobile's service. As a Mobile Virtual Network Operator ("MVNO"), Virgin Mobile selects and markets all aspects of the customer experience,

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<sup>1</sup> See Public Notice, WTB Seeks Comment on CMRS Market Competition, WT Docket 06-17 (rel. January 18, 2006)(hereinafter, "*Public Notice*").

including the selection of handsets, customer service, content on the phones and the company's website, billing systems, all marketing, advertising, and point-of-sale materials, and customers' entertainment applications. As the first U.S. wireless service designed specifically for the needs and desires of lower-income, lower-usage consumers, Virgin Mobile has experienced significant growth, acquiring nearly four million customers – almost six months ahead of its fourth anniversary. Because of this tremendous growth, Virgin Mobile has claimed a spot in the "Top 10" list of U.S. wireless providers.

Virgin Mobile's handsets can be purchased on the company's website or at over 25,000 third-party retail locations nationwide, including Wal\*Mart, Target, Best Buy, and RadioShack. Virgin Mobile currently offers five handset models, ranging from \$29.99 to \$199.99, all of which provide full access to Virgin Mobile's innovative and fun voice and data service offerings. Customers can "top-up," or replenish, their pay as you go accounts in three easy ways: on their handsets, online, or through a top-up card, which can be purchased at over 70,000 stores throughout the United States, including CVS, Rite Aid, and Safeway stores.

#### B. Value Proposition

In contrast to the services offered by most U.S. wireless operators, Virgin Mobile's customers do not have to sign long-term contracts or pass a credit check to obtain service. In addition, because Virgin Mobile does not retain customers through long-term commitments with substantial termination penalties, Virgin Mobile must earn its customers' loyalty each day by offering conveniently-priced, innovative, and high-quality wireless services.

Virgin Mobile currently offers three service options. Virgin Mobile's most popular "Minute2Minute" service charges customers \$0.25 per minute for the first 10 minutes of each day, and \$0.10 per minute after that. Virgin Mobile also offers a "Day2Day" service under

which customers can obtain \$0.10 per-minute pricing all day for a daily charge of \$0.35. Virgin Mobile's final service offer, the "Month2Month" plan, resembles the "bucket" service plans offered by traditional wireless operators by providing 300 monthly minutes to customers for \$29.99. Unlike those bucket plans, however, Month2Month automatically adjusts to provide customers with additional minutes for a flat rate should the customer exceed the initial 300 minutes. Customers know exactly how much they are going to pay on a per-minute basis, pay in advance, and have the ability to add minutes of use on their handset, online, or by phone, using a top-up card or credit card, whenever they want. The Minute2Minute and Day2Day options, moreover, include regulatory fees and taxes – unlike nearly every other service plan offered today. Customers receive this flexibility while enjoying Virgin Mobile's entertaining service offerings. Virgin Mobile believes that much of its success is attributed to these simple and straightforward pricing offers.

### C. Customer Service

Virgin Mobile's extensive focus on high-quality customer service has redefined the prepaid wireless marketplace. Poor customer service historically plagued prepaid services, contributing greatly to the slow adoption of the prepaid service model in the U.S. market. Recognizing the competitive value of high-quality customer service, Virgin Mobile has emphasized customer service as an essential pillar for its ultimate marketplace success from the launch of its service in 2002. Virgin Mobile's intense focus on customer service has been rewarded and its customers have responded accordingly. Over 90 percent of Virgin Mobile's customers indicate that they would recommend Virgin Mobile's service to a friend, while nearly 80 percent already have recommended the service. In addition to receiving high marks from its own customers, independent research gave Virgin Mobile a 92% satisfaction rate among its

customers. J.D. Power also has recognized Virgin Mobile for providing "An Outstanding Customer Service Experience" under its Certified Call Center Program.

## II. STATUS OF CMRS MARKET

### A. Resale Market

Virgin Mobile was the first MVNO to commence nationwide operations in the U.S. Virgin Mobile's rapid success, and the subsequent entry of additional MVNO carriers, confirms the vitality of the resale market and the competitive benefits provided by resold CMRS services. Indeed, resold services can provide significant competition to traditional wireless operators so long as the resale carrier differentiates its service offering from those of the large, national carriers. Merely repackaging and reselling the services of other carriers seldom provides significant competition to the national carriers. In contrast, MVNOs that develop and market unique service offerings targeted to niche demographics traditionally ignored by larger carriers have a proven track record of competitive success. Of particular importance to the success of an MVNO is the adoption of mobile content applications and services that appeal to a targeted customer base. As Virgin Mobile's success has demonstrated, these data, entertainment, and voice applications remain vital to an MVNO's ability to differentiate its service offerings from those of traditional carriers.

The resold wireless market, moreover, has become an important business component for the large, national carriers. Performance results from the most recent quarter confirm that wholesale channels represent an ever-increasing percentage of the national carriers' net customer additions. Additional evidence of the growing importance of resold services is a recent estimate from the Yankee Group which concluded that there were 13.4 million wireless subscribers currently receiving service from a resale provider, nearly triple the 4.7 million customers at the

end of 2003. The Yankee Group also has forecast the total number of resold customers to hit 29 million by 2010, which would represent nearly 12% of all wireless subscribers at that time.

#### B. Prepaid Market

Prepaid service offerings have played an important role in driving the adoption of wireless services for many customers previously unable to subscribe to an increasingly essential service. As many commentators have concluded, the key to driving wireless penetration rates higher is to increase usage rates among lower-income customers. The role of prepaid providers that focus on lower-income customers has grown as the upper-income wireless market has reached the saturation point. A review of wireless operators' performance for the most recent quarter indicates that prepaid services were responsible for a majority of new customer additions for at least one of the national wireless operators. Many analysts also have determined that the future growth in the wireless market will come largely from prepaid service offerings. By expanding the availability of wireless services to those otherwise unable to afford service or those previously ignored by traditional carriers, Virgin Mobile and other prepaid carriers are helping to drive overall wireless penetration rates higher. Indeed, the *Wall Street Journal* has recently reported, "[c]ellphone service is becoming available to many consumers previously shunned by telecom providers."<sup>2</sup>

The competitive response of the national wireless carriers who have launched their own prepaid service models further demonstrates the viability of the prepaid, MVNO business model in the U.S. Other entities, including Earthlink, 7-Eleven, Disney, and ESPN have indicated their intention to enter the MVNO market, further increasing the profile of what was once a largely

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<sup>2</sup> See "Immigrants Are Center of a Niche for Some Cellphone Providers," *The Wall Street Journal*, p.B3, Jan. 31, 2006.

ignored business model. The success of each of these competitive alternatives will depend primarily on their ability to differentiate their services from the service offerings of the large, national carriers. Innovative business models and service offerings targeted to specific demographics and underserved consumer segments can compete effectively against the large, national providers. Clearly, Virgin Mobile's market success has benefited not only its customers, but also all U.S. wireless consumers who now have access to alternate wireless service plans.

### C. Data Services Market

Virgin Mobile's service offerings also include a rich array of innovative non-voice applications. All of Virgin Mobile customers have access to VirginXL or VirginXtras - a variety of music, entertainment, and fun lifestyle features, including ringtones, song clips, and exclusive content from strategic partner MTV. These innovative non-voice applications differentiate Virgin Mobile's service from those that other carriers provide and place Virgin Mobile at the forefront in offering the interactive wireless features and services that customers demand today. Virgin Mobile has captured approximately eight percent of the total U.S. ringtone market - a figure disproportionately larger than the company's total U.S. wireless voice market share. In addition, over 70 percent of Virgin Mobile's customers sent or received text messages during 2005, averaging more than 25 messages per month. Finally, over one-half of Virgin Mobile's customers downloaded at least one ringtone in 2005. As this data demonstrates, Virgin Mobile has become a market leader in a variety of data services, confirming the value in offering innovative entertainment services to customers, especially for newer wireless service providers.

### III. VIRGIN MOBILE CUSTOMER BASE

Traditional wireless operators tend to focus almost exclusively on upper-income consumers, making it difficult for lower-income customer to obtain service because of tightened

credit standards for new subscribers. This focus has permitted these carriers to concentrate exclusively on higher-income (especially business) subscribers to satisfy analysts' need for ever-higher ARPU (Average Revenue Per Unit). A quick review of the pricing plans offered by the large, national providers confirms their intense desire to acquire upper-income, high-usage customers. Nearly all of the nationwide plans offered by the large providers begin at \$40 per month; once taxes and regulatory fees are included, the cost of these plans approaches \$50 per month.

By providing a prepaid, well-priced, and straightforward service, Virgin Mobile has expanded the availability of wireless services to customers who had previously lacked access to this essential service because of financial constraints, questionable (or no) credit standing, or an inability to decipher the confusing array of service plans. Indeed, more than one-third of Virgin Mobile's customers are new to wireless service, and a substantial portion have yearly incomes below \$35,000. Virgin Mobile's specific focus on the youth market also has succeeded, resulting in more than 70 percent of Virgin Mobile's customers being under the age of 34. Virgin Mobile's entry into the wireless market benefits these younger and less-affluent customers by providing a flexible service without long-term contracts. A Virgin Mobile customer can choose to use their phone heavily in one month and not at all in the next month - they need only spend \$20 every 90 days. Without question, younger and lower-income consumers receive advantages from prepaid service, including access to mobile services, value for their money, and access to emergency services on wireless devices.

#### IV. BARRIERS TO ENTRY

In its *Public Notice*, the Commission asks for information regarding any barriers to entry that presently exist in the U.S. wireless market and asks commentors to identify any technical

and economic barriers to entry.<sup>3</sup> Virgin Mobile agrees with the Commission that technical and economic barriers do exist, though the increase in new MVNOs suggests that these barriers are declining. Virgin Mobile cautions the Commission not to focus exclusively on these issues, however, and asks the Commission to investigate the very real potential that state and local taxation and regulation of wireless services could threaten the entry and viability of innovative wireless service operators.

#### A. State and Local Taxation and Regulation of Wireless Service

The greatest threat to the competitive benefits provided by Virgin Mobile and other new wireless entrants is the increasing taxation and regulation of wireless services by state and local authorities. During the past several years, state and local authorities have introduced thousands of pieces of legislation to tax and regulate the wireless industry, including "consumer protection" requirements, E-911 fees, and numerous other taxes and surcharges. State and local taxation and regulation have the direct effect of raising wireless providers' rates, especially the rates of prepaid providers who do not recover these costs directly from customers. Compliance with these taxes and regulations also imposes significant administrative costs on providers, which inevitably will lead to higher end-user rates. Undoubtedly, the dual burden of taxation and regulation will result in higher end-user rates and decreased demand for wireless services.

##### 1. State Taxation

Excessive taxation of wireless services at the state level directly affects end-user rates, with nineteen states currently imposing double-digit state and local taxes and fees on wireless services. The increased rates resulting from these taxes and fees make wireless service less attractive to customers (especially lower-income customers), dampening overall demand for

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<sup>3</sup> See *Public Notice* at P.4.

wireless service. Should these developments continue, wireless operators may be forced to create state or local pricing plans to take into account the drastically different state and local taxes and fees. Most important, lower-income customers bear a disproportionate burden of per-line, rather than usage-based state and local fees and taxes. Despite significant efforts on behalf of the wireless community, most states have failed to adopt meaningful limitations or reforms on the taxation of wireless services and are actively considering new or increased service fees, particularly for emergency services. While a few states have enacted measures to centralize the imposition and collection of wireless fees and taxes, these states have refused to address the more substantive inequity of the high tax burden borne by wireless providers. The excessive taxation of wireless services at the state level remains somewhat ironic, considering that these same state policymakers consistently seek increased investment in telecommunications and wireless infrastructure within their states to drive the availability of next-generation services.

## 2. State Regulation

The trend toward increasing the amount and applicability of state regulations, especially consumer protection requirements, to wireless providers threatens Congress' intentions for a deregulated wireless marketplace and greatly affects wireless carriers' ability to offer services. Once recent estimate concluded that 181 legislative proposals have been introduced in all 50 states during the past several years to enact some form of consumer protection regulation for wireless services.<sup>4</sup> Attempts to impose state-specific regulations on wireless services forces wireless providers to modify their business procedures on a state-by-state basis. This patchwork regulation harms consumers through the elimination of efficiencies resulting from the national marketing, customer care, and administrative operations needed to provide cost-effective

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<sup>4</sup> See *StateScape*, November 18, 2005.

wireless services. These regulations also invariably drive up wireless providers' compliance and administrative costs, resulting in higher end-user rates.

Should the growth in state and local taxation and regulation of wireless services continue, U.S. wireless consumers will forfeit the competition and freedom afforded not only by Virgin Mobile's market entry, but also the entry of other carriers in response to Virgin Mobile's competitive success. Indeed, these developments ultimately could prevent the market entry of many new operators—to the great detriment of wireless customers.

#### B. Universal Service Fund Reform

Virgin Mobile also is concerned about the Commission's intentions to reform the Universal Service Fund ("USF"). Increasing USF contribution obligations threaten innovative business models, especially prepaid wireless service. While Virgin Mobile supports USF reform to preserve the viability of the USF, it supports USF reform that would decrease USF funding obligations on all carriers. As Virgin Mobile has indicated to the Commission, a connections-based USF reform solution would discriminate against providers of prepaid wireless services.<sup>5</sup> A flat monthly USF fee, moreover, would be a regressive fee that would unfairly penalize lower-usage, less-affluent customers that choose prepaid services (and are many of the same people who are the intended beneficiaries of USF policies). For example, a \$1 per month flat fee for USF would represent only 1.7 percent of a hypothetical postpaid subscriber with \$58 in ARPU. In contrast, this fee would represent 3.6 percent of a hypothetical prepaid customer with \$28 in ARPU. A connections-based USF approach also would require lower-income, prepaid customers to pay into the USF even if they had no interstate usage or did not generate carrier revenue in a given month. In this regard, a connections-based approach would place a

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<sup>5</sup> See *Virgin Mobile ex parte notice*, CC Docket 96-45 (filed March 18, 2005).

disproportionate burden on lower-income, prepaid customers, forcing them to subsidize higher-income, higher-usage users. Since customers favoring prepaid plans generally have lower spending and usage patterns, monthly fees represent a higher proportion of their total expenditures on wireless services. In this manner, lower-income, prepaid customers are particularly sensitive to the adverse impact of higher USF contribution rates.

Most prepaid service plans have regulatory fees and taxes fees included in their cost structure. Increased USF obligations, therefore, especially the imposition of a flat monthly USF fee, would force prepaid providers to increase their rates to recover these amounts. In contrast, most postpaid providers simply pass through the charge to customers as a line item on their monthly bill – with no effect on their retail rates. Increased USF contribution rates, therefore, may cause lower-income prepaid customers to drop wireless service altogether because of the higher rates associated with prepaid service.

The FCC should strive to implement regulatory policies that spur increased wireless usage rates among lower-income consumers to drive overall wireless penetration rates higher. To this end, Virgin Mobile has proposed that the FCC exempt certain prepaid customers from payment of any USF connections-based fee.<sup>6</sup> Exemption of lower-income, lower-usage prepaid customers in this manner would eliminate the regressive nature of a connections-based approach, ensuring that these customers have continued access to vital wireless services.

## V. CONCLUSION

Virgin Mobile's rapid marketplace acceptance demonstrates that it is providing the simple, straightforward service offering that the U.S. wireless market previously lacked. Virgin Mobile's market success has benefited U.S. wireless consumers by enabling them to make informed and

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<sup>6</sup> See *Virgin Mobile ex parte notice*, CC Docket 96-45 (filed March 15, 2005).

easy to understand decisions regarding the purchase and use of a wireless service. Virgin Mobile does not require long-term contracts and it does not impose significant termination penalties, empowering customers to change service providers should they decide to do so—substantially increasing competition. As other wireless operators respond to Virgin Mobile's success by offering better prepaid services, consumers benefit further. Finally, Virgin Mobile maintains that the greatest threat to increasing competition are the barriers to entry posed by state and local excessive taxation and regulation of wireless services, as well as the prospect of a flat monthly USF fee.

Respectfully submitted,

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